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Transcript Exhibit(s)

CORP COMMISSION  
DOCKET CONTROL

Docket #(s): T-01072A-12-0472

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Exhibit #: A1, A2, S1

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Arizona Corporation Commission

DOCKETED

APR - 5 2013

DOCKETED BY	<u>NR</u>
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# ORIGINAL

# NEW APPLICATION

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

GARY PIERCE, Chairman  
PAUL NEWMAN  
SANDRA D. KENNEDY  
BOB STUMP  
BRENDA BURNS

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ARIZONA CORPORATION COMMISSION  
DOCKET CONTROL

Arizona Corporation Commission

DOCKETED

NOV 23 2012

DOCKETED BY

nr

IN THE MATTER OF THE APPLICATION OF  
SOUTHWESTERN TELEPHONE COMPANY,  
AN ARIZONA CORPORATION, FOR A  
HEARING TO DETERMINE THE EARNINGS  
OF THE COMPANY, THE FAIR VALUE OF  
THE COMPANY FOR RATEMAKING  
PURPOSES, AND TO INCREASE  
RESIDENTIAL RATES AS NECESSARY TO  
COMPENSATE FOR THE RATE IMPACTS OF  
THE FCC'S USF/ICC TRANSFORMATION  
ORDER

DOCKET NO. T-01072A-12-0472

EXHIBIT

A-1  
ADMITTED

1 Southwestern Telephone Company ("Southwestern Telephone"), an Arizona corporation,  
2 hereby applies pursuant to A.R.S. § 40-250 and the Commission's Rule R 14-2-103 for a  
3 determination of Southwestern Telephone's earnings and the fair value of its investment and  
4 requests that its residential rates be increased as necessary to compensate for the rate impacts of  
5 the Federal Communication Commission's November 18, 2011, USF/ICC Transformation Order  
6 ("USF/ICC Order").

7 **I. BACKGROUND**

8 On November 18, 2011, the Federal Communications Commission issued the USF/ICC  
9 Order. The USF/ICC Order transitions the outdated federal universal service programs and most  
10 inter-carrier compensation systems into a new Connect America Fund ("CAF"). The FCC's  
11 press release characterized the USF/ICC Order as "the most significant policy step ever taken to  
12 connect all Americans to broadband."

1 The USF/ICC Order will reduce inter-carrier compensation rates to zero by July 1, 2020,  
2 for rate of return companies, with limited recovery from customers and partial recovery from the  
3 CAF. The recovery from the CAF will phase out over time at 5% annually.

4 Southwestern Telephone is a small rate-of-return regulated Incumbent Local Exchange  
5 Carrier ("ILEC"). Of particular importance to Southwestern Telephone and other rural ILECs,  
6 the USF/ICC Order adds new rules that will reduce federal high-cost loop support to carriers by  
7 the amount their flat-rate residential local service rates fall below a specified annual urban rate  
8 floor.<sup>1</sup> The rate floor includes, if any, state subscriber line charges, state universal service fees,  
9 and mandatory extended area service charges. The FCC's order establishes local residential rate  
10 floors of \$10.00 as of June 1, 2012, and \$14.00 as of June 1, 2013, with the floor thereafter being  
11 determined annually by the FCC's Wireline Competition Bureau, based on a nationwide  
12 average.<sup>2</sup>

13 Federal and state support funding are vital to a robust telecommunications network in  
14 high cost areas. To maintain federal loop support, Southwestern Telephone and other rural  
15 ILECs must increase local rates to the FCC-mandated residential rate floors. Otherwise, the  
16 amount of federal support funds will be reduced dollar-for-dollar for each customer by the  
17 difference between the existing local rate and the new rate floor. If local rates are not increased,  
18 the new FCC rules will reduce funds coming to the state of Arizona and negatively impact  
19 customers living in high-cost areas in the state.

20 Low customer density makes Southwestern Telephone dependent on high-cost federal  
21 support mechanisms. It is important that the company be allowed to increase local rates, to the  
22 FCC determined annual rate floors, in order to maintain its existing federal support. Therefore,  
23 Southwestern Telephone requests the Commission to approve local rate increases to the \$14 rate  
24 floor established by the FCC's order.

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<sup>1</sup> 41 C.F.R. § 54.318.

<sup>2</sup> USF/ICC Order paragraph 236 states the most recently available nationwide average local rate from 2008 was \$15.62.

1   **II.   SOUTHWESTERN TELEPHONE**

2           Southwestern Telephone Company is a corporation duly organized and existing under  
3 and by virtue of the laws of the State of Arizona. Southwestern Telephone is authorized to  
4 engage in and is now engaged in the conduct of a general communications business within the  
5 State of Arizona.

6   **III.   SUMMARY OF REQUEST**

7           This application is made pursuant to the provisions of A.R.S. §§ 40-250 and 40-367, and  
8 Commission Rule R14-2-103. The Commission last considered Southwestern Telephone's rates  
9 in Docket No. T-01072B-00-0379, which resulted in Commission Decision 63685, dated May  
10 24, 2001.

11          Southwestern Telephone's local residential one-party rates are \$11.25/month and local  
12 residential two-party rates are \$9.60/month.<sup>3</sup> These rates are below the federal \$14/month rate  
13 floor that will go into effect on June 1, 2013. The rate floor for 2014 and thereafter will be  
14 determined by an annual FCC survey.

15          Southwestern Telephone is aware that many parties, including the Commission, have  
16 appealed the USF/ICC Order. However, in the meantime, Southwestern Telephone and other  
17 rural ILECS must comply with all provisions of the USF/ICC Order and will remain subject to  
18 the increased local residential rate floors and the corresponding losses of federal support funds.

19          Southwestern Telephone's loss of federal support funds would be particularly difficult to  
20 bear. As the attached schedules demonstrate, Southwestern Telephone's return on investment is  
21 already negative. Put another way, Southwestern Telephone's jurisdictional earnings are  
22 negative. Losing federal support funds will only drive earnings deeper into the red.

23          In connection with this application, Southwestern Telephone has filed exhibits which  
24 include a schedule of the specific rate changes requested and the impact of the revenue generated  
25 on the company's financial position. Southwestern Telephone asks that the Commission

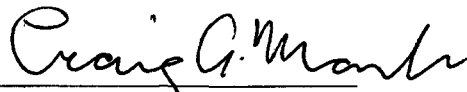
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<sup>3</sup> While the subscribers have continued to pay the lower rate for two party service, the actual service provided to each of these subscribers is one-party service.

1 determine the fair value of the company's investments for ratemaking purposes and stipulates to  
2 use original cost less depreciation for those purposes. Because the next opportunity to affect  
3 federal support funds is June 1, 2013, Southwestern Telephone further asks that the Commission  
4 set new rates at or above the \$14.00 floor to be effective no later than June 1, 2013.

5 To facilitate processing of this application, Southwestern Telephone asks that the  
6 Commission waive any provisions of Commission Rule R14-2-103 not required by the Arizona  
7 Constitution and laws.

8 Respectfully submitted on November 23, 2012.

9  
10   
11

12 Craig A. Marks  
13 Craig A. Marks, PLC  
14 10645 N. Tatum Blvd., Ste. 200-676  
15 Phoenix, Arizona 85028  
16 (480) 367-1956 (Direct)  
17 (480) 367-1956 (Fax)  
18 [Craig.Marks@azbar.org](mailto:Craig.Marks@azbar.org)  
19 Attorney for Southwestern Telephone Company

**Original and 13 copies filed**  
on November 23, 2012, with:

Docket Control  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007

By:   
Craig A. Marks

# **Southwestern Telephone Company**

Streamlined filing to support residential rate increase due to FCC

floor implementation and resulting HCL loss.

October 31, 2012

# **Southwestern Telephone Company**

**October 31, 2012**

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# Southwestern Telephone Company

October 31, 2012

REGULATED RESULTS OF OPERATIONS FOR TWELVE MONTHS ENDING JUNE 30, 2012  
REFLECTS CHANGES EFFECTIVE WITH ARC AND CAF IMPLEMENTATION - YEAR 1

	TOTAL TELEPHONE OPERATIONS	ADJUSTMENTS	Ref	ADJUSTED RESULTS	INTERSTATE	INTRASTATE
	(a)	(b)	(c)	(d)	(e)	(f)
1 Local	648,107	-1,751 #7		646,356	0	646,356
2 Universal Service Fund (USF-HCL) and Safety Net Additive (SNA)	516,941	-38,565 #6,6		478,376	0	478,376
3 Access Revenues	1,678,166	#12,3		1,628,921	1,161,314	467,607
4 Billing & Collecting	34,245	-50,245 4,7		34,245	14,194	20,051
5 Other Misc., Uncollectibles	60,011			60,011	25,643	34,368
6 Total Operating Revenues	2,938,470	-90,561		2,847,909	1,201,151	1,646,758
7 Plant Specific Expenses	589,067	49,296 #11		638,363	274,053	364,310
8 Plant Nonspecific Expenses	305,751	19,623 #7,8,11		325,374	160,924	164,450
9 Depreciation & Amortization Expenses	890,128	91,020 #11		1,001,148	434,699	566,449
10 Customer Operations Expenses	307,308	14,136 #11		321,444	109,980	211,464
11 Corporate Operations Expenses	388,126	23,466 #11		411,622	134,038	277,584
12 Other Operating Taxes and (Income)	35,071	113,736 1,72	#9,10,1	148,807	66,562	82,245
13 Nonregulated Adjustment (Part 69 W61)		-309,264 #11		-309,264		0
14 Total Operating Expenses	2,815,451	2,043		2,617,494	870,992	1,746,502
15 OPERATING RETURN BEFORE TAXES	323,019	-92,604		230,415	330,159	-99,744
16 State Income Taxes (SIT) (6.97%)	19,755	-3,695 #13		16,060	23,012	-6,952
17 Federal Income Taxes (FIT) (35%)	107,044	-32,020 #13		75,024	107,501	-32,477
18 Total Operating Income Taxes	126,799	-35,715		91,084	130,514	-39,429
19 Total Expenses and Income Taxes	2,742,250	-33,672		2,708,578	1,001,506	1,707,073
20 Net Operating Income	196,220	-56,889		139,331	199,645	-60,315
21 Total Year-End Rate Base	4,138,383	0		4,138,383	1,572,768	2,565,615
22 Return on Rate Base (Ln 20 / Ln 21)						-2.4%
23 Estimated Revenue from Local Rate Increase						53,368
24 State Income Taxes (SIT) (6.97%)						3,720
25 Federal Income Taxes (FIT) (35%)						17,377
26 Increase in Net Operating Income						32,271
27 Net Operating Income After Increase (Ln 20 + Ln 26)						-28,044
28 Return on Rate Base After Increase (Ln27 / Ln21)						-1.1%

## ASSUMPTIONS

Used 2011 Cost Study run dated 04/30/2012 for Part 36 separation;  
Separated results based upon frozen 2000 traffic factors  
Separated results based upon 6/30/2012 financials, interstate rules, adjusted for Part 64 activities  
Working Capital included for all jurisdictions



**Southwestern Telephone Company**  
**Adjustments to Revenues and Expenses**

Ref	Account	Description	Debit	Credit
1.	5082200	Access Revenues	554	
	5083000	Access Revenues	398	
	Exclude			952
	To remove prior period (2008) interstate revenue requirement adj.			
2.	5082200	Access Revenues	6,355	
	5083000	Access Revenues	1,525	
	Exclude			7,880
	To remove prior period (2009) interstate revenue requirement adj.			
3.	5082100	Access Revenues	41,299	
	5082200	Access Revenues		35,266
	5083000	Access Revenues	2,762	
	Exclude			8,795
	To remove prior period (2010) interstate cost study true-up.			
4.	5082200	Access Revenues		4,185
	5083000	Access Revenues		1,541
	Exclude		5,726	
	To remove prior period (2010) interstate revenue requirement adj.			
5.	5082110	Universal Service Fund	38,064	
	PPA			38,064
	To adjust for Federal HCL projected change for 2012.			
6.	5082110	Universal Service Fund	501	
	PPA			501
	To remove prior period HCL revenues.			
7.	5001000	Local Revenues	1,751	
	5082200	Access Revenues	15,034	
	5084220	Access Revenues	23,310	
	6540010	Plant Nonspecific Exp		689
	Exclude			39,406
	Year 1 FCC Order ICC intrastate and interstate revenue and expense 5% reductions.			
8.	6540011	Plant Nonspecific Exp	2,732	
	PPA			2,732
	To remove prior period (2009 & 2010) 499A interstate expense adjustments and DSL FUSC refund.			
9.	Not Used			

**Southwestern Telephone Company**  
**Adjustments to Revenues and Expenses**

Ref	Account	Description	Debit	Credit
-----	---------	-------------	-------	--------

10. Not Used

11.	6112004	Plant Specific Exp	1,152	
	6121004	Plant Specific Exp	9,024	
	6232004	Plant Specific Exp	32,724	
	6423004	Plant Specific Exp	6,396	
	6532004	Plant Nonspecific Exp	17,580	
	6561000	Depreciation Exp	91,020	
	6611004	Customer Operations Exp	11,532	
	6623304	Customer Operations Exp	2,604	
	6728904	Corporate Operations Exp	23,496	
	7130000	Other Operating Income	101,208	
	7240900	Other Operating Taxes	12,528	
	7990000	Nonregulated Exp		309,264

To reverse transfer of estimated Part 69 interstate expenses for WBI (Internet) to enable proper Part 36 allocation of total company expenses.

12. Not Used

13.	7220000	Federal Income Tax		32,020
	7230020	State Income Tax		3,695
	PPA		35,715	

Adjust income taxes to remove prior period amounts and for adjustments to results.

# Southwestern Telephone Company

## Year 1 Estimated ICC Impact of FCC Order

### Base Line of Eligible Recovery:

	Total	5% Reduction	
Interstate SWA (Includes LSS)	300,681	(15,034)	Interstate Access Revenue
Intrastate Terminating Access	466,191	(23,310)	Intrastate Access Revenue
Recip Comp Revenue	35,016	(1,751)	Local Revenue
Recip Comp Expense	(13,789)	689	Plant Non-Specific Intrastate Local
Total Base of Eligible Recovery	788,099	(39,406)	
		AJE #7	

**Southwestern Telephone Company**

Rate Base

As June 30, 2012

	Total Company	INTERSTATE	INTRASTATE
Plant in Service	\$ 18,154,231	\$ 7,765,628	\$ 10,388,603
Accumulated Depreciation	(13,564,659)	(5,975,255)	(7,589,404)
Net Plant in Service	\$ 4,589,572	\$ 1,790,373	\$ 2,799,199
Plant Under Construction	44,519	18,961	25,558
Material & Supplies	110,921	32,293	78,628
Deferred Income Taxes	(742,194)	(316,074)	(426,120)
Cash Working Capital	135,565	47,215	88,350
Rate Base	<u>\$ 4,138,383</u>	<u>\$ 1,572,768</u>	<u>\$ 2,565,615</u>

**Southwestern Telephone Company**  
**For Twelve Ending June 30, 2012**

**CALCULATION OF CASH WORKING CAPITAL (CWC)**

CASH OPERATING EXPENSES	Total Company	INTERSTATE	INTRASTATE
Total Operating Expenses	\$ 2,617,494	\$ 870,992	\$ 1,746,502
Depreciation & Amortization	1,081,148	434,699	646,449
Cash Operating Federal Income Taxes	75,024	107,501	(32,477)
Cash Operating State & Local Taxes	16,060	23,012	(6,952)
Total Cash Operating Expenses	\$ 1,627,430	\$ 566,807	\$ 1,060,624
% LAG (30 days)	8.33%	8.33%	8.33%
TOTAL CASH WORKING CAPITAL	\$ 135,565	\$ 47,215	\$ 88,350

# Southwestern Telephone Company

## Proposed Rate Design

June 30, 2012 TTM Average Units\*

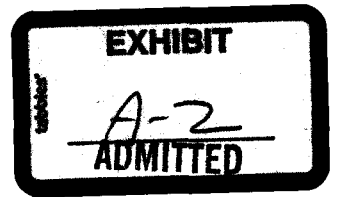
(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)
Service Description	Average Units (a)	Current Rates	2011 Annual Revenues	Proposed Rates	Proposed Revenues	Proposed Change Revenue	Proposed Change Percent
<b>Basic Service</b>							
Residence One-Party	1,614	\$ 11.25	\$ 217,890	\$ 14.00	\$ 271,152	\$ 53,262	24.44%
Residence Two-Party	2	\$ 9.60	\$ 230	\$ 14.00	\$ 336	\$ 106	45.83%
<b>Estimated Revenue from Local Rate Increase</b>						<b>\$ 53,368</b>	

### Notes:

\*Average units are used to capture seasonal fluctuations.

(a) No reduction made for line loss.

Residential Lines		Year	Type	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2009	One-Party	2009	One-Party	2,916	2,982	2,964	2,492	1,759	1,556	1,481	1,443	1,449	1,609	2,179	2,498
		2009	Two-Party	5	5	4	4	4	4	4	4	4	4	4	4
		2009 Total		2,921	2,987	2,968	2,496	1,763	1,560	1,485	1,447	1,453	1,613	2,183	2,502
2010	One-Party	2010	One-Party	2,613	2,667	2,647	2,249	1,584	1,425	1,345	1,320	1,338	1,473	1,989	2,234
		2010	Two-Party	4	4	4	4	4	4	4	4	4	2	2	2
		2010 Total		2,617	2,671	2,651	2,253	1,588	1,429	1,349	1,324	1,342	1,475	1,991	2,236
2011	One-Party	2011	One-Party	2,317	2,376	2,343	2,033	1,501	1,324	1,242	1,225	1,223	1,339	1,752	1,984
		2011	Two-Party	2	2	2	2	2	2	2	2	2	2	2	2
		2011 Total		2,319	2,378	2,345	2,035	1,503	1,326	1,244	1,227	1,225	1,341	1,754	1,986
2012	One-Party	2012	One-Party	2,066	2,095	2,067	1,798	1,363	1,208						
		2012	Two-Party	2	2	2	2	2	2						
		2012 Total		2,068	2,097	2,069	1,800	1,365	1,210						



AZ SW tel Cust Feb 2013

BUSINESS OFFICE NUMBER 7301  
02-13-13  
EXCHANGE NUMBER 0419  
928-927-6525

BILLING DATE  
ACCOUNT NUMBER  
REGISTRATION ID  
PAGE NUMBER

1 OF 4

03/05/13

Due Date

STARR BEARCAT

Total	Previous Balance	Payments Thru 02/06/13	Adjustments Thru 02/06/13	Balance	Current Charges
\$100.42	\$100.42 \$100.42	\$100.42CR	\$ .00	\$ .00	

THANK YOU FOR YOUR PROMPT PAYMENT.

SUMMARY OF CURRENT CHARGES

LOCAL SERVICE	23.21
INTERNET SERVICES	77.21
TOTAL CURRENT CHARGES	\$100.42

# DISCONNECTABLE TOTAL 25.12

payments, You're enrolled in TDS ePay. If you have NOT signed up for automatic  
please visit [www.tds-epay.com](http://www.tds-epay.com) to make your payment.

FOR INQUIRIES SEE NUMBERS LISTED ON THE BACK OF THIS PAGE.

Please detach bottom portion and return with your payment.

♀

AZ SW tel Cust Feb 2013  
 BUSINESS OFFICE NUMBER 7301  
 02-13-13  
 EXCHANGE NUMBER 0419  
 928-927-6525

BILLING DATE  
 ACCOUNT NUMBER  
 REGISTRATION ID  
 PAGE NUMBER

2 OF 4

02-13-13 BILLING DATE  
 928-927-6525 ACCOUNT NUMBER  
 06-10-10 CONTROL DATE  
 TDS TELECOM 730  
 P.O. BOX 608  
 LANCASTER WI 53813-0608  
 Amount Late Fee Assessed Total Amount  
 Enclosed After Due

03/05/13 \$100.42

Make Check Payable To:

TDS TELECOM 730 STARR BEARCAT  
 PO BOX 94510 PO BOX 3185  
 PALATINE IL 60094-4510 QUARTZSITE AZ 85359-3185

♀

BUSINESS OFFICE NUMBER 7301 BILLING DATE  
 02-13-13  
 EXCHANGE NUMBER 0419 ACCOUNT NUMBER  
 928-927-6525 REGISTRATION ID  
 PAGE NUMBER

3 OF 4

# PAYMENTS AND ADJUSTMENTS DETAIL

DATE	DESCRIPTION	AMOUNT
02-04	PAYMENT - THANK YOU	100.42CR

## LOCAL SERVICE DETAIL

TO	QTY	DESCRIPTION	FROM
#		BASIC NON-BASIC	
03-12-13		1ONE-PARTY RESIDENCE ACCESS LINE - BASE RATE AREA	02-13-13
#		11.25	
03-12-13		1NONPUBLISHED NUMBER	02-13-13
#		1.50	
02-13-13		1ARIZONA UNIVERSAL SERVICE FUND SURCHARGE	02-13-13
#		.01	
03-12-13		1FEDERAL SUBSCRIBER LINE CHARGE	02-13-13
#		6.50	



		AZ SW tel Cust Feb 2013	
#	1	FEDERAL ACCESS RECOVERY CHARGE	02-13-13
03-12-13		.50	
	1	STATE 911 TAX	02-13-13
02-13-13		.20	

#	FEDERAL EXCISE TAX	
		.63
#	FEDERAL UNIVERSAL SERVICE CHARGE	
		1.13
#	ARIZONA STATE SALES TAX	
		.84
#	LA PAZ COUNTY TRANSACTION PRIVILEGE TAX	
		.19
#	QUARTZSITE CITY TRANSACTION PRIVILEGE TAX	
		.32
#	TELECOMMUNICATION DEVICES FOR THE DEAF TAX	
		.12
#	ARIZONA CORPORATION COMMISSION TAX	
		.02

TOTAL LOCAL SERVICE           \$23.21

# You are responsible for the Total Amount Due on your bill. However,  
 non-payment of any flagged charges may result in disconnection of your local service.

You Do Not Have A Primary Intralata Carrier  
 You Do Not Have A Primary Interlata Carrier

ORIGINAL

MEMORANDUM  
RECEIVED

TO: Docket Control

2013 MAR 14 A 8:55

FROM: Steven M. Olea  
Director  
Utilities Division

COMMUNICATIONS  
DOCKET CONTROL

DATE: March 14, 2013

RE: IN THE MATTER OF THE APPLICATION OF SOUTHWESTERN TELEPHONE COMPANY FOR A HEARING TO DETERMINE THE EARNINGS OF THE COMPANY, THE FAIR VALUE OF THE COMPANY FOR RATEMAKING PURPOSES, AND TO INCREASE RESIDENTIAL RATES AS NECESSARY TO COMPENSATE FOR THE RATE IMPACTS OF THE FCC'S USF/ICC TRANSFORMATION ORDER. (DOCKET NO. T-01072A-12-0472)

Attached is the Staff Report for Southwestern Telephone Company's application to increase residential rates to compensate for the rate impacts of the Federal Communications Commission's Universal Service Fund/Intercarrier Compensation ("FCC's USF/ICC") Transformation Order.

*weighted* Staff recommends approval of *Southwestern* ~~Arizona~~ Telephone Company's request to increase its monthly residential local exchange service rate from \$11.25 to \$14.00, effective June 1, 2013.

SMO:AFF:tdp\MAS

Originator: Armando Fimbres



**SERVICE LIST FOR: SOUTHWESTERN TELEPHONE COMPANY**  
**DOCKET NO.: T-01072A-12-0472**

**Mr. Craig A. Marks**  
**CRAIG A. MARKS PLC**  
**10645 N. Tatum Boulevard, Suite 200-676**  
**Phoenix, Arizona 85028**

STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION

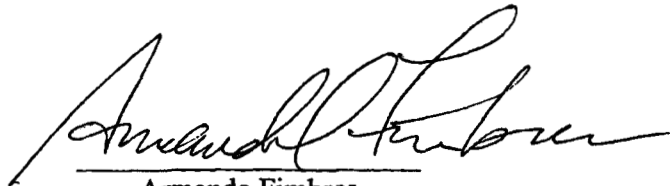
SOUTHWESTERN TELEPHONE COMPANY  
DOCKET NO. T-01072A-12-0472

IN THE MATTER OF THE APPLICATION  
OF SOUTHWESTERN TELEPHONE COMPANY FOR A HEARING  
TO DETERMINE THE EARNINGS OF THE COMPANY,  
THE FAIR VALUE OF THE COMPANY FOR RATEMAKING PURPOSES,  
AND TO INCREASE RESIDENTIAL RATES AS NECESSARY TO COMPENSATE  
FOR THE RATE IMPACTS OF THE FCC'S USE/ICC TRANSFORMATION ORDER.

MARCH 14, 2013

### STAFF ACKNOWLEDGMENT

The Staff Report for Southwestern Telephone Company (Docket No. T-01072A-12-0472) was the responsibility of the Staff member listed below.

A handwritten signature in black ink, appearing to read "Armando Fimbres", written over a horizontal line.

Armando Fimbres  
Executive Consultant III

**EXECUTIVE SUMMARY OF  
SOUTHWESTERN TELEPHONE COMPANY  
DOCKET NO. T-01072A-12-0472**

On November 23, 2012, Southwestern Telephone Company ("Southwestern Telephone" or "Applicant") filed an application for a determination of its earnings and the fair value of its investment and requested that its residential rates be increased to compensate for the rate impacts of the Federal Communication Commission's ("FCC's") November 18, 2011, Universal Service Fund/Intercarrier Compensation ("USF/ICC") Transformation Order ("USF/ICC Order") pursuant to Arizona Revised Statute ("A.R.S.") § 40-250 and the Arizona Corporation Commission's ("Commission's") Arizona Administrative Code ("A.A.C.") R14-2-103.

Staff recommends that the Southwestern Telephone monthly residence single line local exchange rate increase from the weighted average residential local service rate of \$11.25 to \$14.00 to address the impact of the FCC's USF/ICC Order. Staff believes the proposed increase is just, fair and reasonable for the following reasons:

- The increase is necessitated by the FCC's November 18, 2011 USF/ICC Order;
- The increase is necessary to preserve the entirety of the Federal Universal Service Fund ("FUSF") funds that may flow to Southwestern Telephone pursuant to the FCC's rules;
- The increase will minimize/reduce the amount of future rate increase; and
- The increase will allow the Applicant to receive matching funds from the FUSF.

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## **INTRODUCTION**

On November 23, 2012, Southwestern Telephone Company ("Southwestern Telephone" or "Applicant") filed an application for a determination of its earnings and the fair value of its investment and requested that its residential rates be increased to compensate for the rate impacts of the Federal Communication Commission's ("FCC's") November 18, 2011, Universal Service Fund/Intercarrier Compensation ("USF/ICC") Transformation Order ("USF/ICC Order") pursuant to Arizona Revised Statute ("A.R.S.") § 40-250 and the Arizona Corporation Commission's ("Commission's") Arizona Administrative Code ("A.A.C.") R14-2-103. A.A.C. R14-2-103(A)(1) requires specific financial and statistical information be filed with a request by a public service corporation doing business in Arizona for a determination of the value of the property of the corporation and of the rate of return earned. Southwestern Telephone submitted, as recommended by Staff, a streamlined filing in which Southwestern Telephone submitted the following six exhibits to support the requested increase in residential rates:

- Adjusted Results Twelve Months Ending June 30, 2012
- Adjustments
- Year 1 FCC Order ICC Impact
- Rate Base
- Working Capital
- Rate Design.

## **BACKGROUND**

Southwestern Telephone is a corporation duly organized and existing under and by virtue of the laws of the State of Arizona. Southwestern Telephone is authorized to engage in and is engaged in the conduct of a general communications business within the State of Arizona. The Commission last considered Southwestern Telephone's rates in Docket No. T-01072B-00-0379, which resulted in Commission Decision No. 63685, dated May 24, 2001. Southwestern Telephone is a rate-of-return ("RoR") regulated incumbent local exchange carrier ("ILEC") serving non-metro communities.

On November 18, 2011, the FCC issued the USF/ICC Order. The USF/ICC Order transitions the outdated federal universal service programs and most intercarrier compensation systems into a new Connect America Fund ("CAF"). The FCC's press release characterized the USF/ICC Order as "the most significant policy step ever taken to connect all Americans to broadband."



In its USF/ICC Order, the FCC stated that it will reduce intercarrier compensation rates to zero by July 1, 2020, for RoR companies, with limited recovery from customers and partial recovery from the CAF. The recovery from the CAF will phase out over time at 5 percent annually. The USF/ICC Order adds new rules that will reduce federal high-cost loop support ("FHCLS") to carriers by the amount their flat-rate single line residential local service rates fall below a specified local service rate floor. The rate floor includes state subscriber line charges, state universal service fees, and mandatory extended area service charges, if any are assessed. The FCC's order establishes single line residential local service rate floors of \$10.00 as of June 1, 2012, \$14.00 as of June 1, 2013, with the floor thereafter being determined annually by the FCC's Wireline Competition Bureau, based on a nationwide average.

To maintain FHCLS, Southwestern Telephone and other rural ILECs must increase single residential local rates to the FCC-mandated residential rate floors. Otherwise, the amount of FHCLS funds will be reduced dollar-for-dollar for each customer by the difference between the existing single line residential local rate and the new rate floor. If single line residential local rates are not increased, the new FCC rules will reduce FHCLS for Southwestern Telephone and other applicable ILECs. Southwestern Telephone's current weighted average residential local service rate of \$11.25 is above the \$10.00 rate floor. Therefore, with this application, Southwestern Telephone only seeks Commission approval to raise its residence local service rate to the rate floor of \$14.00 by June 1, 2013

#### **CONSUMER SERVICES**

On November 28, 2012, the Records Section of the Corporation Division responded that Southwestern Telephone is in Good Standing. A review of Consumer Services database revealed that no complaints, inquiries and opinions were received pertaining to Southwestern Telephone for the period January 1, 2009-November 28, 2012.

#### **COMPLIANCE**

A check of the Utilities Division Compliance Section database showed that Southwestern Telephone is in compliance with all items.

#### **OPERATING INCOME STATEMENT**

Southwestern Telephone submitted Adjusted Regulated Results of Operations for Twelve Months Ending June 30, 2012 information in its streamlined filing. The submitted information was accepted without adjustment for the purposes of this streamlined application.

***Operating Revenue and Expenses***

According to the information provided by the Applicant, Southwestern Telephone Total Intrastate Operating Revenues for Twelve Months Ending June 30, 2012 were \$1,646,758. Subcategories of Total Intrastate Operating Revenues are noted below:

Local	\$646,356
USF-HCL <sup>1</sup> & Safety Net	\$478,376
Access Revenues	\$467,607
Other	\$54,419

The Company also provided information that stated that its Total Intrastate Operating Expenses for Twelve Months Ending June 30, 2012 were \$1,746,502. Subcategories of Total Intrastate Operating Expenses are noted below:

Plant Expenses	\$528,760
Depreciation & Amortization	\$646,449
Customer Operations	\$211,464
Corporate Operations	\$277,584
Other	\$82,245

***Operating Income***

As provided by the Applicant, Southwestern Telephone Total Intrastate Operating Income for Twelve Months Ending June 30, 2012 was negative \$99,744 before taxes and negative \$60,315 after taxes.

**RATE BASE**

According to Southwestern Telephone, its rate base is \$4,138,383, as stated in the table below:

**Southwestern Telephone Company**

Rate Base

As of June 30, 2012

	Total Company	INTERSTATE	INTRASTATE
Plant in Service	\$ 18,154,231	\$ 7,765,628	\$ 10,388,603
Accumulated Depreciation	(13,564,659)	(5,975,255)	(7,589,404)
Net Plant in Service	\$ 4,589,572	\$ 1,790,373,	\$ 2,799,199

<sup>1</sup> Universal Service Fund – High Cost Fund

Plant Under Construction	44,519	18,961	25,558
Material & Supplies	110,921	32,293	78,628
Deferred Income Taxes	(742,194)	(316,074)	(426,120)
Cash Working Capital	135,565	47,215	88,350
Rate Base	\$ 4,138,383	\$ 1,572,768	\$ 2,565,615

### **CUSTOMER BASE**

Southwestern Telephone reported 1,986 residential lines and 924 business lines in its April 15, 2012 Utilities Annual Report.

### **REVENUE REQUIREMENT**

As stated above, the Applicant's filing was based on a streamlined basis and rates will not be set based on rate of return regulation. Therefore, the Applicant's filing does not contemplate rate adjustments based on revenue requirement analysis.

### **RATE DESIGN**

The Applicant did not propose a rate design as required by R14-2-103. The Applicant is seeking to increase its weighted average residential local exchange service rate by \$2.75.<sup>2</sup> The Applicant's filing only contemplates changes to residence local exchange rates to compensate for the rate impacts of the FCC's USF/ICC order. With this filing, Staff will only address the monthly increase of all residence local exchange service rates to \$14.00.

### **STAFF ANALYSIS**

Staff did not perform a regulatory audit of the information submitted by Southwestern Telephone. However, Staff reviewed the information filed in the context of the FCC's November 18, 2011 USF/ICC Order which is intended to transition the outdated federal universal service programs and most intercarrier compensation systems into a new CAF.

Staff has analyzed this application in terms of whether there were fair value implications. For the purposes of this matter the Applicant stipulated to the use of original cost less depreciation as the basis for a determination of its fair value rate base. The Applicant states that its intrastate rate base is \$2,565,615. The Applicant provided information that indicates that its Total Intrastate Operating Revenue for the Twelve Months Ending June 30, 2012 was \$1,646,758. According to the Applicant, the annual revenue effect of the increase in local

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<sup>2</sup> According to Southwestern Telephone's Rate Design Exhibit, it provided One-Party service to 1,208 Residential customers and Two-Party service to 2 Residential customers, as of June 30, 2012

telephone service rates to \$14.00 is \$53,368.<sup>3</sup> Compared to the Applicant's total revenues, any revenue impact from this rate increase would be small and any impact on the Applicant's fair value rate of return would be de minimus. Southwestern Telephone's Operating Income would remain negative, therefore, the rate of return is not meaningful in this case, i.e., less than zero.

#### **STAFF'S RECOMMENDATIONS**

Staff recommends that the Southwestern Telephone monthly residence local exchange rate increase from the weighted average residential local service rate of \$11.25 to \$14.00 beginning June 1, 2013, to address the impact of the FCC's USF/ICC Order. Staff believes the proposed increase is just, fair and reasonable for the following reasons:

- The increase is necessitated by the FCC's November 18, 2011 USF/ICC Order;
- The increase is necessary to preserve the entirety of the FUSF funds that may flow to Southwestern Telephone pursuant to the FCC's rules;
- The increase will minimize/reduce the amount of future rate increase; and
- The increase will allow the Applicant to receive matching funds from the FUSF.

Staff has reviewed the rate application and the federal rule changes that have prompted the rate application. Staff concludes that the costs appear reasonable and appropriate under the unique circumstances of this case. However, Staff's recommendation in these unique circumstances should not be viewed as precedent for the processing of future rate case applications.

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<sup>3</sup> Based on 1,614 one-party and 2 two-party residence lines.